

DEPARTMENT OF STATE REVENUE

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0474

Sales Tax

For Tax Periods 1995-1997

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ISSUES

I. Sales Tax—Material Handling System

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8

Taxpayer protests the assessment of tax on its purchase of a material handling system.

II. Tax Administration—Negligence Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests the assessment of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is a plastic injection mold manufacturer. The Department of Revenue conducted an audit for the years of 1995-1997 and issued assessments for sales tax on various properties. Taxpayer paid the assessments and protested two of the items assessed, as well as a ten percent (10%) negligence penalty. An administrative hearing was held on the matter. The Letter of Findings (LOF) sustained one of the protested items, and denied the protests for a Material Handling System and the ten percent penalty. Taxpayer requested and was granted a rehearing.

I. Sales Tax—Material Handling System

DISCUSSION

Taxpayer protests the assessment of sales tax on a material handling system. At the initial hearing, taxpayer protested that the system did more than simply transport raw

materials, but provided no documentation to support that position. At the rehearing, taxpayer provided documentation which explained the functions of the material handling system, and also provided documentation to show that it had already paid state sales tax at the time of purchase. Included among the system's functions are: transporting plastic pellets from the storage silos to the injection molding machines, mixing the different colored pellets with other additives to achieve proper end color and content, measuring the pellets, drying the pellets, and collecting dust from the vacuum system before it enters the vacuum pumps. These steps are controlled by a computer control station and occur before the pellets are melted and fed into the injection molds.

IC 6-2.5-5-3(b) states:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

The documentation provided at the rehearing shows that the system is also directly used in direct production, not merely in pre-production activity.

Equipment involved in pre-production activity is subject to sales tax, as provided in 45 IAC 2.2-5-8(c)(4)(G), which lists an example of non-exempt equipment:

Equipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production.

As taxpayer's letter requesting rehearing states:

The equipment at issue (material handling system) consists of a series of hoppers that are attached to various raw material silos as well as feeding hoppers that are physically attached to injection molding presses.

The material handling system is used for both exempt and non-exempt purposes. The procedure to handle such equipment is found in 45 IAC 2.2-5-8(c)(7), which explains:

A computer is used 40% of the time to perform the functions described in Example (5) [exempt] and 60% of the time to perform the functions described in Example (6) [non-exempt]. The taxpayer is entitled to an exemption for the computer equipment, including related equipment such as that described in Example (5), equal to 40% of the gross retail income attributable to the transaction or transactions in which the computer equipment was purchased.

Here, since the system is used for both exempt and non-exempt purposes, taxpayer is entitled to an exemption equal to the portion of the equipment which is directly used in

the direct production of tangible personal property. The percentage of the equipment which is used to remove raw materials from storage in the silos prior to introduction into the production process is taxable. The percentage of equipment which is used in the production process, such as blending, drying, and measuring is exempt. Since the vacuum system moves the material both before and during the production process, the dust collectors are exempt to the extent they remove dust generated by the production process, and taxable to the extent they remove dust generated prior the production.

FINDING

Taxpayer's protest is sustained for the portion of the material handling system and computer control station that is used for production and denied for the portion that is used for pre-production activity. The exempt amount of state sales tax paid at time of purchase will be applied against the remaining amount of the other assessments from the audit.

II. Tax Administration—Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty. The relevant regulation is 45 IAC 15-11-2(c), which states in part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has demonstrated that it exercised ordinary business care and prudence in carrying out its duty to pay sales tax. Therefore, taxpayer has affirmatively established reasonable cause, and the negligence penalty shall be waived.

FINDING

Taxpayer's protest is sustained.